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SUBJECT:



DDI #01382-88

Central Intelligence Agency  
Office of the Deputy Director for Intelligence

2 May 1988

NOTE TO: Director of Central Intelligence

SUBJECT: The Washington Post Article on CIA's  
Annual Report to the Joint Economic  
Commission (JEC)

The item in the Post refers to an annual briefing provided to Senator Proxmire's committee by CIA at an unclassified level. These briefings have been going on since the 1960s and focus primarily on the Soviet and Chinese economies. This year's hearing on China took place on 21 April.

We should have given you some notice about this briefing because we usually get some press play. Congressional Affairs is aware of these.



Richard J. Kerr  
Deputy Director for Intelligence

STAT

Attachments:

- A. Chinese Economic Policy
- B. Gorbachev's Economic Program



L-231-10



**Directorate of  
Intelligence**

**CHINA:  
ECONOMIC POLICY AND PERFORMANCE  
IN 1987**

**April 1988**

**Gorbachev's Economic Program: Problems Emerge**

13 April 1988

A paper prepared by the Central Intelligence Agency and the Defense Intelligence Agency for the Subcommittee on National Security Economics of the Joint Economic Committee, Congress of the United States.

# Office of Current Production and Analytic Support

## CIA Operations Center

News Bulletin

THE WASHINGTON POST  
FRONT PAGE2 MAY 1988  
ITEM NO. 1

## Chinese Grow Cautious on Reforms, CIA Says

### *Efforts Said to Surpass Those of Soviets Despite Loss of 'Clear Goal'*

By Lena H. Sun  
Washington Post Staff Writer

Nearly a decade after China adopted an ambitious blueprint for reshaping its economy, the country's leaders are becoming increasingly cautious about how to proceed, according to a study released yesterday by the Central Intelligence Agency.

Despite the current note of caution, China's reforms in agriculture, enterprise management, foreign trade and private enterprise are way ahead of those undertaken by the Soviet Union, according to the CIA's annual report to the congressional Joint Economic Committee.

Although reform remains the political watchword among leaders of the nation of more than 1 billion people, the report said, the past year has been characterized by "the loss of a clear goal as well as the proper path to be followed, in contrast to 10 years ago when simply implementing pragmatic policies constituted a reform agenda. Therefore, although all Chinese leaders now consider themselves reformers, a consensus over the ultimate shape of a reformed China is notably lacking."

The report's sober tone contrasts with the more optimistic picture painted last year, when the CIA said reform policies "appeared to set the stage for major steps forward in 1987."

Chinese leaders and economists now speak of a longer time frame for reform—of taking decades to achieve basic goals. "This trend towards a longer time horizon may in fact be a more realistic assessment of the changes China must go through as it moves toward a more market-oriented economy," the report said.

At the same time, in sharp contrast to the Soviet economy, which has had a mixed performance during several years of leader Mikhail Gorbachev's *perestroika*, or reconstruction, policies, the Chinese economy continued to grow rapidly last year.

The production of goods and services increased 9.4 percent, greater than the 7.8 percent increase of 1986, but below the double-digit growth rates of 1984 and 1985. Labor productivity improved, industrial output increased, and the trade deficit declined.

In a report last week, the CIA and Defense Intelligence Agency concluded that after growing sharply in 1986, the Soviet economy last year slipped back to the economic stagnation that prevailed before Gorbachev took power three years ago.

Although China continued to make gains, the report also noted signs of deep-rooted economic difficulties.

Last year, inflation increased and grain production grew only marginally, prompting China to import grain after two years of being a net exporter. One-fifth of urban households showed a decline in their real incomes. Although the official inflation rate was reported to be 10 percent, some cities recorded double-digit inflation.

Last March, Premier Li Peng reaffirmed that the country's top economic priorities in 1988 would be controlling inflation and improving agricultural output.

Last week, Chinese officials revealed that grain output, the cornerstone of Chinese agriculture, will not meet a 1990 production target of 450 million tons until 1992. Memories of past famines make declines in output a sensitive issue.

Unlike grain, rural industry and commerce are among the most dynamic segments of the economy, employing about 15 percent of China's labor force, roughly 85 million people, the report said. Rural industrial output grew by 36 percent in 1987.

This growth reflects in part China's loosening of central controls

over peasants in 1985, a move that prompted many to turn to lucrative cash crops and rural industries.

Urban industrial output grew 15 percent last year, in part because of the use of the contract system, under which state enterprises sign performance contracts with supervisory bureaus specifying minimum output, earnings and taxes. By the end of last year, 75 percent of the country's large- and medium-sized state industrial and commercial enterprises had adopted the contract system.

Strains in the economy, however, led Chinese leaders to postpone once again some important programs, such as the reform of the irrational price structure.

"Without price reform, China's attempts to make enterprises more responsive to market signals—and to hold them accountable for poor investment, production, and personnel decisions via the initiation of bankruptcy proceedings—will fall short," the report said. "But considerable uncertainty remains over precisely how to accomplish needed price adjustments without disrupting the economy, provoking complaints among consumers, or substantially increasing the state's subsidy burden."

Food prices have risen dramatically in recent months. Last week, an official at the State Pricing Bureau said many major Chinese cities, including Shanghai, are introducing food subsidies aimed at cushioning urban residents against a new round of price increases that were to start yesterday.

The CIA estimated that China's defense budget increased modestly in 1987. But because Beijing has given the military lower priority under the reform program, defense spending continues to drop as a share of national income.

Sen. William Proxmire, (D-Wis.) of the Joint Economic Committee accused the CIA of keeping the American public "in the dark" about China's arms trade, which is not mentioned in the report.

China has been selling arms to both Iran and Iraq, Proxmire said, adding that the need to use scarce foreign currency to import grain "contributed to China's decision to become a major arms exporter."



Washington, D. C. 20505

11 FEB 1988

OCA 88-0412

The Honorable William Proxmire  
Chairman  
Subcommittee on National Security Economics  
Joint Economic Committee  
United States Senate  
Washington, D. C. 20510

STAT

Dear Mr. Chairman:

The Director has asked me to respond to your letter of 2 February, inviting him to appear before the Joint Economic Committee for a session in March and one in April dealing with the Soviet and Chinese economies.

Unfortunately, the Director will be unable personally to appear at these hearings. Mr. Douglas J. MacEachin, the Director of our Office of Soviet Analysis and [redacted] Deputy Chief China Division, the Office of East Asia Analysis, will be the Agency's principal witnesses at these hearings.

Thank you for the detailed list of topics provided in your letter. They will serve as a useful guide to the analysts framing the Joint Economic Committee testimony. I understand that Mr. Richard Kaufman, Assistant Staff Director, has already met on a number of occasions with these analysts in an effort to ensure that our testimony is useful and addresses the key issues you have raised.

I can assure you that both the Office of Soviet Analysis and the Office of East Asia Analysis are hard at work to ensure that we have another productive exchange.

Sincerely yours,

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✓ John L. Helgerson  
Director of Congressional Affairs



STAT

OCA/HM

(10 Feb 88)

L-231-11

TO:

		ACTION	INFO	DATE	INITIAL
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Remarks D/OCA to respond.

STAT

Executive Secretary  
4 Feb 88

Date

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From: John Helgerson

\_\_\_ We plan to prepare an  
answer for your signature.

✓ \_\_\_ We plan to prepare an  
answer for my signature.

\_\_\_ No answer expected or required *(Doug MacEachin of OI normally briefs)*

\_\_\_ John, I prefer to \_\_\_\_\_

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EXECUTIVE DIRECTOR

Washington, DC 20510

February 2, 1988

The Honorable William H. Webster  
Director of Central Intelligence  
Central Intelligence Agency  
Washington, D.C. 20505

Dear Judge Webster:

This letter is to invite you to testify in the Joint Economic Committee annual hearings on the Soviet and Chinese economies. The hearing on the Soviet Union will be held on Thursday, March 24, 1988, at 10:00 a.m. The hearing on China will be held on Thursday, April 21, 1988, at 10:00 a.m. The hearings on both days will be held before the Subcommittee on National Security Economics and will be in closed executive session.

You may know that I have been conducting annual hearings on this subject with spokespersons from the Central Intelligence Agency and the Defense Intelligence Agency since 1974 in a series entitled "Allocation of Resources in the Soviet Union and China." In 1986 and 1987, the CIA and DIA presented their assessments of the Soviet Union as a joint report on the same day. This is a useful framework in which to receive official intelligence estimates and I would like to use that approach again. I would like the CIA to present a separate report on China.

Our respective staffs have had preliminary discussions about the topics to be covered. There has been excellent cooperation on all sides, for which I am very grateful.

It may be helpful to you for me to indicate some of the areas of interest to the Subcommittee. I would like a review of Soviet economic performance in 1987 together with an overall assessment of Gorbachev's initiatives to restructure the Soviet economy. My understanding is that economic performance was poor last year in most sectors, with the possible exceptions of agriculture and energy. What effects will poor performance, especially in industry, have on the targets in the current Five-Year Plan? Is there any evidence that Gorbachev is retreating or modifying his plans to restructure the economy? What is the current assessment of the modernization program?

DCI  
EXEC  
REG

L-231-15

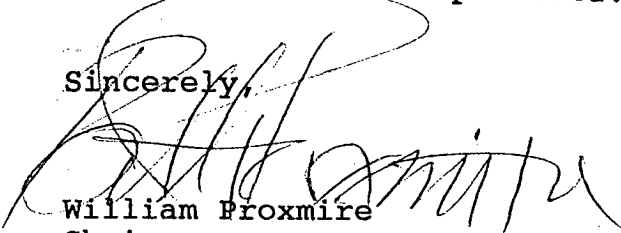
Hon. William H. Webster  
February 2, 1988  
Page Two

I would like a full discussion of Soviet defense spending and related issues. Is it possible to assess Gorbachev's defense policies and the changes he has introduced? Please provide a breakdown, on an unclassified basis, of Soviet defense allocations along functional lines, including strategic offense, strategic defense, conventional forces, naval forces, and tactical air forces, so that we can understand the recent trends. Is there evidence of any significant reductions or increases in spending or deployments in any of these areas or in any regions of the world? Is there any evidence of a shift in priorities as between defense and civilian allocations?

I am also interested in trade issues. Please discuss recent developments in the Soviet trade sector and relations with the United States, Western Europe, and other regions of the world, including China. Does Gorbachev perceive the United States as imposing a "technological blockade" on the Soviet Union, and if so how much importance does he place on "breaking" the blockade? To what extent has the USSR been able to obtain Western technology controlled by the United States from other sources? Does the lack of access to Western technology constitute a substantial constraint on Soviet economic development and growth? Is it likely that the recent US-USSR summit and other developments will lead to greater Soviet access to Western technology? What significance do you place on the Soviet efforts to enter into joint ventures? Are the Soviets likely to pursue efforts to join international institutions, such as GATT and IMF, and what is the significance of their initiatives in this direction.

I am deeply appreciative of the efforts that go into these preparations, and I look forward to another productive exchange.

Sincerely,



William Proxmire  
Chairman  
Subcommittee on National  
Security Economics

WP:rkt